

EXECUTIVE SUMMARY

To: Committee for the Study of Electronically Delivered Products

From: The Department of Revenue

Date: April 16, 2008

Subject: **50-State Survey of Taxation on Digital Products Executive Summary**

At the request of the Committee, the Department of Revenue (Department) surveyed how the 50 states tax digital goods. The Federation of Tax Administrators is currently in the process of gathering the same information and was very helpful in sharing the information it had compiled thus far. The survey provides each state's basic sales tax rate and then looks at six types of digital goods, specifically:

- Online Data Processing Services,
- Downloaded Software,
- Downloaded Books,
- Downloaded Music,
- Downloaded Movies/Digital Video, and
- Downloaded Other Electronic Goods.

The table lists an "E" for exempt for states that do not tax that category of digital goods. For states that do tax the category of digital goods, the tax rate is listed.

Key areas of interest in the 50-State Study include:

- Thirty-two (32) states tax the sale and download of prewritten software as the sale of tangible personal property subject to retail sales tax.
- Nineteen (19) of those 32 states also tax other digital goods.
- Five (5) states do not have a retail sales tax.
- Twenty-six (26) do not tax digital goods (excluding prewritten software).
- Nebraska does not currently enforce retail sales tax on digital goods other than electronic mailing lists.
- Connecticut is the only state with a different tax rate for digital goods versus other products subject to retail sales tax.

States that the Department thought would be of particular interest to the Committee are:

- New Jersey
- Nebraska
- Indiana
- Connecticut
- California

50-State Survey of Digital Goods Tax Treatment

Legend: Green = the 19 states that tax digital goods
 White = the 5 states that do not have a sales tax
 Red = the 26 states that do not tax digital goods (excluding software)
 E = exempt from sales tax
 * = member or associate member of SSUTA

STATE	Basic Sales Tax Rate	Online Data processing services	Software - Downloaded	SSUTA Books - Downloaded	SSUTA Music - Downloaded	SSUTA Movies/Digital Video - Downloaded	SSUTA Other Electronic Goods - Downloaded
AL	4%	4% ¹	4%	4%	4%	4%	4%
AR*	6.0 ²	E	E	E	E	6	E
AZ	5.60 ³	E ⁴	5.60 ⁵	5.60 ⁶	5.60 ⁷	5.60 ⁸	5.60 ⁹
CA	7.25 ¹⁰	E ¹¹	E	E	E	E	E
CO	2.90	E	E	2.90	2.90	2.90	2.90
CT	6.0	1.0 ¹²	1.0	1.0	1.0	1.0	1.0
FL	6.0	E ¹³	E ¹³	E ¹³	E ¹³	E ¹³	E ¹³
GA	4.0	E	E	E	E	E	E
HI	4.0 ¹⁴	4.0	4.0	4.0	4.0	4.0	4.0
IA*	5.0 ¹⁵	E	E	E	E	E	E
ID	6.0	E	6.0	6.0	6.0	6.0	6.0
IL	6.25	E	6.25 ¹⁶	E	E	E	E
IN*	7.0	E	7.0	E	E	E	E
KS*	5.30	E	5.30	E	E	E	E
KY*	6.0	E	6.0 ¹⁷	6.0 ¹⁷	6.0 ¹⁷	6.0 ¹⁷	6.0 ¹⁷
LA	4.0	E	4.0	4.0	4.0	4.0	4.0
ME	5.0	5.0	5.0	5.0	5.0	5.0	5.0
MD	6.0 ¹⁸	E	E	E	E	E	E
MA	5.0	E	5.0 ¹⁹	E	E	E	E
MI*	6.0	E	6.0 ²⁰	E	E	E	E
MN*	6.50 ²¹	E	6.50 ²²	E	E	E	E
MS	7.0	E	7.0	7.0	7.0	7.0	7.0
MO	4.20	E	E	E	E	E	E
NE*	5.50 ²⁴	E	5.50 ²⁵	5.50 ²⁵	5.50 ²⁵	5.50 ²⁵	5.50 ²⁵
NV*	6.50 ²⁶	E	E	E	E	E	E
NJ*	7.0	E	7.0	7.0	7.0	7.0	7.0
NM	5.0 ²⁷	5.0	5.0	5.0	5.0	5.0	5.0
NY	4.0	E	4.0 ²⁸	E	E	E	E
NC*	4.25 ²⁹	E	E	E	E	E	E
ND*	5.0 ³⁰	E	5.0 ³¹	E	E	E	E
OH*	5.50 ³²	5.5	5.50 ³³	E	E	E	E
OK*	4.50 ³⁴	E	E	E	E	E	E
PA	6.0	E	6.0 ³⁵	E	E	E	E
RI*	7.0	E	7	E	E	E	E
SC	6.0 ³⁶	E ³⁷	E ³⁸	E	E ³⁹	E ³⁹	E
SD*	4.0 ⁴⁰	4.0	4.0	4.0	4.0	4.0	4.0
TN*	7.0	E	7	E	E	E	E
TX	6.25	6.25 ⁴¹	6.25	6.25	6.25	6.25	6.25
UT*	4.75 ⁴²	E	4.75	4.75	4.75	4.75	4.75
VT*	6.0	E	6.0	E	E	E	E
VA	5.0	E	E	E	E	E	E
WA*	6.5	E	6.5	6.5	6.5	6.5	6.50 ⁴³
WV*	6.0	E	6.0	6.0	6.0	6.0	6.0
WI	5.0	E	5.0 ⁴⁴	E	E	E	E
WY*	4.0	E	4.0	4.0	4.0	4.0	4.0
AK	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DE	N/A	N/A	N/A	N/A	N/A	N/A	N/A
MT	N/A ²³	N/A	N/A	N/A	N/A	N/A	N/A
NH	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OR	N/A	N/A	N/A	N/A	N/A	N/A	N/A

This survey is from multiple sources. The Federation of Tax Administrators (FTA) is currently performing the same survey and was able to provide the above information for over 30 states. Many of the footnotes were provided to the FTA as part of their survey, but are not directly on point for digital goods. We thank the FTA for their assistance and generosity in sharing the information they have gathered to this point. The remaining states were surveyed directly by the Department.

¹ Taxable as the result of an ALJ Opinion and Preliminary Order entered November 17, 2006.

² Alteration or repair of motor vehicles, aircraft, farm machinery and implements, motors, tires and batteries, boats, electrical appliances, instruments, machines, bicycles, office equipment, shoes taxable.

³ State transaction privilege tax is imposed under 16 separate tax classifications. The state tax rate is 5.6% for most classifications, although prime contracting tax is imposed on 65% of a business's gross receipts. Currently, the state tax rates are: 0% for the commercial lease classification (county and city taxes may apply), 5.5% for the transient lodging classification, and 3.125% for the mining classification. In addition to tax imposed at the state level, county and city privilege taxes may apply. The imposition of county taxes "piggybacks" state taxes.

⁴ Exempt unless related to the leasing or renting of prewritten software (i.e., as an application service provider).

⁵ Downloaded prewritten (canned) software is taxable under the retail classification.

⁶ Taxable under the retail classification.

⁷ Taxable under the retail classification.

⁸ Taxable under the retail classification.

⁹ Depending on the taxpayer's primary business activities, taxable under the retail classification or telecommunications classification.

¹⁰ The statewide sales tax rate is comprised of various increments. Allocation is: 5.00% to the state general fund, .50% to a local revenue fund, .50% to a local public safety fund, .25% to state fiscal recovery fund, and 1.00% to local and county governments for a total statewide tax of 7.25%. The amount allocated to local and county governments changed on July 1, 2004. Prior to that date, local and county governments received 1.25% of the tax collected. As of that date, 0.25% was shifted from the local and county governments to the state fiscal recovery fund. In addition, individual cities, counties and special district may impose local taxes of up to an additional 1.50%. The tax rate in the Tax Rate column is shown as the statewide rate. The rate will be higher if the location where the sale takes place has additional district taxes.

¹¹ These services are generally all exempt from sales and use tax provided no tangible personal property is actually transferred in connection with these services.

¹² All of these purchases would be considered as purchases of computer services and subject to the 1% tax rate on computer services if the recipient of the download is located in Connecticut.

¹³ Not taxable if products are downloaded via internet and no TPP is shipped to end user.

¹⁴ Hawaii does not have a sales tax. Instead, General Excise Tax (GET) is imposed on the value of products, gross proceeds of sales or gross income. A wholesale of services rate of 1/2% is allowed for services that are resold. Also, exported services are exempt.

¹⁵ Local option sales tax coverage of services is similar to state coverage. There are some exceptions, among them no local option tax on sales by the Dept. of Transportation.

¹⁶ Applies only to "canned", i.e. prewritten, consumer software not custom designed for unique user.

¹⁷ KRS 139.160

¹⁸ Rate effective July 1, 2008.

¹⁹ Tax applies to canned but not custom software.

²⁰ Prewritten computer software is taxable regardless of delivery method

²¹ Local taxes that apply to the same items subject to MN 6.5% general tax rate are: Albert Lea .5%, Austin .5%, Baxter .5%, Bemidji .5%, Brainerd .5%, Cook County 1%, Duluth 1%, Hennepin County .15%, Hermantown .5%, Mankato .5%, Minneapolis .5%, New Ulm .5%, Owatonna .5%, Proctor .5%, Rochester .5%, St. Cloud Area .5%, St. Paul .5%, Two Harbors .5%, and Willmar .5%.

²² Downloaded packaged or canned software is taxable. Downloaded custom software is not taxable.

²³ However, boxing, sparing and wrestling matches are subject to 5% gross receipts tax. Public contractors, passenger tramways and public markets subject to license fee measured by gross receipts.

²⁴ City or county local tax of 0.5%, 1.0% or 1.5% may apply when the state tax is due. See Reg. 1-007 for Gross Receipts Defined.

²⁵ See Reg. 1-088 for the taxation of prewritten software. Under *May Broadcasting v. Boehm*, 241 Neb. 660, 490 N.W.2d 203 (1992), digital goods are subject to retail sales tax in Nebraska. However, Nebraska has not enforced retail sales tax on digital goods other than electronic mailing lists. Electronic mailing lists are subject to retail sales tax under *Am. Bus. Info. Inc. v. Egr*, 264 Neb. 574, 650 N.W.2d 251 (2002).

²⁶ For all services listed TPP consumed, used, or sold in conjunction with the service is taxable. Additionally, there are County option taxes allowed for a total rate of up to 7.75% in electing counties.

²⁷ Excludes government services; many farming and ranching, provided by certain nonprofit entities other than research and development performed out of state but used in state, for resale, etc.

²⁸ Custom software is exempt

²⁹ Items subject to the general State rate of sales or use tax are subject to the applicable local rate of tax.

³⁰ In general, service providers must pay sales or use tax on the cost of all tangible personal property used to provide services.

³¹ Canned programs.

³² May include county or transit district add-on tax rate.

³³ Prewritten computer software.

³⁴ Local option rate is in addition to state sales tax rate.

³⁵ Custom software is exempt.

³⁶ In most counties, the SCDOR administers and collects a local sales and use tax on behalf of local jurisdictions ranging from 1% - 2%. See SC Information Letter #07-4 (or its updated version) for more details. Note: Department advisory opinions (revenue rulings) and regulations referenced above can be found at the Department's website at www.sctax.org under "Law and Policy."

³⁷ Must meet the definition in the statute to be exempt as "data processing." If it is a charge to access or use the website and does not meet the definition for data processing, then it is subject to the tax as a communications service.

³⁸ However, if there is a charge to access a website to use the software (ASP), then such is subject to the tax as a communications service. See SC Revenue Ruling #06-8 and SC Revenue Ruling #05-13.

³⁹ However, if there is a separate charge to listen to it online or via the phone, then such is subject to the tax as a communications service

⁴⁰ Exempts health and education services; services performed on projects located outside South Dakota; sales commissions; social services; and some other categories by specific lists.

⁴¹ Twenty percent of the value of data processing or information services is exempt.

⁴² 4.75 state rate - local rates range between 1% and 3.25%. State rate will change to 4.65 as of January 1, 2008.

⁴³ RCW 82.08.705 and 82.12.705 provide an exemption from sales and use tax for investment management companies and financial institutions purchasing standard financial information delivered electronically.

⁴⁴ The sale or license of computer software that is not custom computer software is subject to tax. Such software is deemed to be tangible personal property (sec. 77.51(20), Wis. Stats.) (taxable). Custom computer programs are not taxable.

KEY DISCUSSION POINTS from the 50-state study

In the 50-state survey process, a couple of key issues and examples became apparent. For example, 32 states tax electronically delivered software as tangible personal property just as the Streamlined Sales and Use Tax Agreement (SSUTA) has defined it, but only 19 of those states tax other electronically delivered products. Additionally, certain states have recently adopted or proposed new legislation that addresses how and when the sale of digital products is subject to retail sales tax.

WASHINGTON

The SSUTA has split products delivered electronically (digital goods) into two groups (software is a separate issue with its own definitions):

- 1) “Specified Digital Products” (movies, music, and books) and
- 2) “Products ‘Transferred Electronically’” (all other digital goods)

Neither group of digital goods can be taxed as the sale of tangible personal property under retail sales tax statutes. The definitions for “specified digital products” were effective January 1, 2008, and member states must be compliant within two years (January 2010). The provisions for other products “transferred electronically” are effective January 1, 2010, and member states must be compliant by January 1, 2012.

Because of the September 20, 2007, amendment to SSUTA that defined digital goods (audio-visual, audio, books, and all other digital goods) as not being tangible personal property, Washington will not be compliant with SSUTA after 2009, with respect to digital movies, music, and books, and after 2011, with respect to other digital goods, if it continues to tax digital goods as tangible personal property. This Study will need to provide the legislature with possible tax treatment options.

SOURCING & THE STREAMLINED SALES AND USE TAX AGREEMENT (SSUTA)

Under SSUTA, sales of digital goods would be sourced as follows:

- Source the sale to the seller’s place of business if the purchaser receives the digital good at the seller’s place of business.
- Source the sale to the location where the purchaser receives the item if the purchaser receives the item at a location other than the seller’s place of business.
- Source the sale to the purchaser’s address available in the seller’s business records (use of this address cannot represent bad faith).
- Source the sale to the purchaser’s address obtained at the time of sale (e.g., purchaser’s payment instrument).

Should the sourcing rules above not work, default to the origin sourcing rules: digital goods are sourced to the address where the item is first made available for transmission by the seller.

NEW JERSEY

New Jersey, a Streamlined Sales and Use Tax Agreement (SSUTA) member, passed legislation subjecting the sale of digital goods to retail sales tax. New Jersey defines digital goods as:

"Digital property" means electronically delivered music, ringtones, movies, books, audio and video works and similar products, where the customer is granted a right or license to use, retain or make a copy of such item. Digital property does not include video programming services, including video on demand television services, and broadcasting services, including content to provide such services.

Of particular interest is New Jersey's description of how to apply its SSUTA compliant sourcing rules to digital goods.

Digital property is subject to sales tax when the property is electronically delivered to the customer at an address in New Jersey. If the property is not received by the purchaser at the seller's New Jersey business location or at the purchaser's New Jersey location, the sale is subject to New Jersey sales tax if either the seller's business records or the address provided by the purchaser during the sale indicate a New Jersey billing address. For example, if a New Jersey resident is traveling in another state and downloads music to a hand held electronic device, the sale of the digital property is subject to New Jersey sales tax because the customer's billing address is in New Jersey. Digital property is also subject to the compensating use tax.

NEBRASKA

Nebraska, also a SSUTA member state, has introduced legislation that adopts the SSUTA definitions of digital audio works, digital audiovisual works, digital books, and digital codes, as well as defines "electronically delivered." The legislative committee report states that sales of digital products are taxable under Nebraska sales tax law as interpreted by the Nebraska Supreme Court in *May Broadcasting v. Boehm*, 241 Neb. 660, 490 N.W.2d 203 (1992), but that the taxation of digital products has not been generally enforced. LB 916 would codify taxability of digital products in statute and provide for enforcement. Currently, Nebraska only enforces that retail sales tax on electronic mailing lists under *Am. Bus. Info. Inc. v. Egr*, 264 Neb. 574, 650 N.W.2d 251 (2002).

The bill explains that the receipt of digital products occurs when possession or making first use of the digital good occurs. The bill taxes digital goods, no matter what ownership rights the buyer has (permanent, time limited, or subscription based). However, "sales-for-resale" of digital products would be exempt from sales tax.

INDIANA

Indiana introduced legislation adding the digital products definitions from SSUTA. It is similar to Nebraska's pending legislation, but only adopts the definitions as far as they apply to permanent digital products.

CONNECTICUT

Of the 50 states, Connecticut has established the most unique tax treatment of digital goods. Connecticut has established a specific one percent (1%) tax rate different than its usual 6% retail sales tax rate that only applies to sales of "Computer-Related Services," including digital goods. This would be similar to Washington defining digital goods as a retail service subject to a new retail sales tax rate. Computer-Related Services include:

. . . programming, code writing, modification of existing programs, feasibility studies, and installation and implementation of software programs and systems even where these services are rendered in connection with the development, creation, or production of canned or custom software, or the license of custom software.

Computer and data processing services, as defined in Conn. Agencies Regs. §12-426-27(b)(1), include providing computer time, storing and filing information, retrieving or providing access to information, and providing consulting services.

The list of services in the regulation does not exclude other services from the scope of computer and data processing services. (See Conn. Agencies Regs. §12-426-27(k).) Data scanning, creating custom software, computer training, and online access to information are within the scope of taxable computer and data processing services. Computer and data processing services are subject to tax in Connecticut if the benefit of the services is received in this state.

Connecticut Department of Revenue Services, Policy Statement PS 2006(8). Digital goods such as music, video, and books (both downloaded and streamed) would fall under online access to information.

CALIFORNIA

California law does not currently tax the sale of digital goods (including software) unless the sale includes delivery of tangible personal property. However, in their current legislative session a bill has been introduced that would subject almost all sales of electronically delivered products to retail sales tax. The bill uses a digital equivalent analysis for the definition of “digital property.”

(1)(f) “Digital property” includes products like music, movies, and books, which, if delivered in a tangible storage media, would be subject to sales and use tax in this state under the Sales and Use Tax Law, and, as such, is the digital equivalent of tangible personal property.

The bill goes on to require the State Board of Equalization to “draft proposed regulation that would provide that tangible personal property...includes digital property.” There is some criticism and debate that this requirement is merely a way to avoid the 2/3 majority vote required for new taxes. Because the specifics have yet to be drafted, we do not know how California would source sales of digital goods.

STATES THAT DO NOT TAX DIGITAL GOODS

At the Committee’s last meeting, we discussed New York and Tennessee as examples of states that do not tax the sale of digital goods. Both states do not tax digital goods because, like almost all of the 27 states that do not tax digital goods (excluding prewritten software), they do not consider digital goods other than prewritten software to be tangible personal property.